

# Iowa Legislative Fiscal Bureau

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## Iowa's Tobacco Settlement: Review of Securitization and Legislation

### ISSUE

This *Issue Review* provides an overview of Iowa's tobacco settlement, the securitization process, and the potential for cash flow problems in future fiscal years.

### CODE AUTHORITY

Chapter 12, Code of Iowa  
Chapter 12E, Code of Iowa

### BACKGROUND

On November 20, 1998, 46 states approved a settlement agreement with the four major tobacco industry manufacturers that comprised 99.4% of the U.S. cigarette market. The manufacturers agreed to a settlement valued at \$206.4 billion to be paid over 25 years to settle tobacco-related lawsuits filed by the states. The Master Settlement Agreement (MSA) covered 39 states that filed lawsuits and seven states that had yet to sue, and does not apply to the four states that previously settled their lawsuits.

**Industry Payments** – The funding provisions of the settlement include:

- An annual industry payment in perpetuity to the 46 settling states plus \$12.7 billion in “up-front” payments. Up-front payments were distributed in December 1998 and are scheduled to continue through January 2003. Annual payments will total \$195.9 billion through the year 2025 and will be adjusted annually for inflation and sales volume.
- \$8.6 billion for a strategic contribution fund that will be paid to states over a 10-year period, beginning April 2008, and will be allocated based on efforts expended to resolve the state lawsuits against tobacco companies. Iowa's share will be approximately \$234.0 million.
- \$50.0 million for an enforcement fund available to states to prosecute settlement violations. Payments will be made to a national escrow agent and made available to states as needed for prosecution.

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- \$1.45 billion for a sustained advertising program to counter youth tobacco use and educate consumers about tobacco-related diseases. Payments will be made to a foundation that will use the funds to administer a national campaign.

Iowa will receive approximately \$1.98 billion (0.9%) of the total funds allocated for distribution to the states. The estimated receipts include strategic payments, receipts due from the Master Settlement Agreement, and net litigation payments. The estimate assumes an average annual decline in cigarette sales of 2.7% through 2004. The average annual decline for succeeding years is assumed to be 1.6%. Estimated payment amounts, however, may change significantly once volume and inflation adjustments are computed. An inflation adjustment equal to the greater of the Consumer Price Index, or 3.0%, is applied to each year's payment amount. A volume adjustment is also applied to each year's payment amount to reduce payment, if cigarette sales decrease compared to the 1997 volume.

The General Assembly passed HF 2579 (Tobacco Settlement Authority Act) during the 2000 Legislative Session, creating the Tobacco Settlement Authority with the governing board comprised of the Treasurer of State, the State Auditor, and the Director of the Department of Management. The Act began the process necessary for the State to sell its future tobacco settlement payments due from the Master Settlement Agreement.

The 2001 General Assembly passed SF 532 (Tobacco Securitization Act) that authorized securitization of the tobacco settlement payment. The Tobacco Settlement Authority issued \$40.0 million in taxable bonds and \$604.2 million in tax-exempt bonds. The net tax-exempt proceeds (\$540.0 million) were placed in the Tobacco Settlement Trust Fund Restricted Capital Funds Account. These funds are used for litigation payments, qualified capital projects, and certain debt service. The net taxable proceeds (\$39.6 million) were placed in the Endowment for Iowa's Health Account to create an endowment for future appropriations for health-related programs. The 2001 General Assembly also created the Healthy Iowans Tobacco Trust, which provides a mechanism to appropriate funds from the Endowment for health-related programs.

### **2002 Legislative Session**

The 2002 General Assembly passed several Acts which impacted the Endowment, Restricted Capital Fund, and the Healthy Iowans Tobacco Trust:

- Senate File 2304 (FY 2002 Budget Adjustment Act) made an across-the-board reduction of 1.0% for FY 2002 that reduced the General Fund appropriation to the Endowment by \$72,000. The Act transferred \$15.0 million in wagering tax receipts from the Endowment to the General Fund, and transferred \$7.0 million from the Endowment to the General Fund.
- House File 2245 (FY 2002 Medicaid Supplemental Appropriations Act) appropriated \$2.5 million from the Endowment to the Department of Human Services (DHS) for Medicaid.
- House File 2075 (2002 Endowment Reimbursement Act) committed future General Fund receipts for reimbursing the Endowment up to \$91.5 million for several appropriations made by the 2002 General Assembly.
- House File 2615 (FY 2003 Healthy Iowans Tobacco Trust Appropriations Act) transferred \$9.0 million in FY 2003 wagering tax receipts from the Endowment to the Healthy Iowans Tobacco Trust. The Act also eliminated the FY 2003 General Fund appropriation of \$27.1 million to the Endowment.

- Senate File 2315 (FY 2003 School Aid Foundation Act) appropriated \$20.0 million from the Endowment's FY 2003 wagering tax allocation for School Foundation Aid. The General Fund appropriation for School Foundation Aid was reduced by \$20.0 million.
- House File 2623 (FY 2003 Salary Adjustment Act) amended SF 2315 to eliminate the requirement that the first \$20.0 million in wagering tax receipts be transferred to the General Fund. This action was required due to cash flow concerns.
- House File 2614 (FY 2003 Infrastructure Appropriations Act) appropriated \$16.8 million from the Endowment's wagering tax allocation for Tuition Replacement.
- Senate File 2317 (Tobacco Settlement Enforcement Act) provided a FY 2002 supplemental appropriation of \$945,000 to the Treasurer of State for payment of litigation fees incurred pursuant to the Master Settlement Agreement. The appropriation was made from the tax-exempt bond proceeds of the Restricted Capital Fund.
- House File 2627 (FY 2003 Second Omnibus Appropriations Act) transferred \$9.0 million from the Endowment to the General Fund.
- House File 2625 (FY 2002 Adjustments and Transfers Act) increased the amount of money to be repaid to the Endowment from \$91.5 million to \$93.5 million.

**Attachment 1** provides the estimated revenues and appropriations for the Endowment for Iowa's Health Account in FY 2002 and FY 2003. **Attachment 2** provides a balance sheet for the Healthy Iowans Tobacco Trust Fund. **Attachment 3** illustrates the estimated revenues and appropriations for the Restricted Capital Fund.

### **FUTURE FUNDING ISSUES**

The Endowment for Iowa's Health Account was originally envisioned to be used as a stable funding source for future appropriations related to health care programs. The transfers, deappropriations, and appropriations made from the Endowment for Iowa's Health Account reduced the Endowment's long-term earnings potential. The General Assembly has committed future General Fund receipts to repay the Endowment for transfers, deappropriations, and appropriations made during the 2002 Legislative Session. This action limits future General Assemblies' ability to set funding priorities. The transfers, deappropriations, and appropriations made from the Endowment have also made it necessary for the Department of Management to closely monitor the monthly cash flow of the Endowment. Allocating appropriations from the Endowment during the first six months of a fiscal year has been complicated by two factors:

- The FY 2003 beginning balance is lower than originally projected.
- The majority of the dedicated revenue sources (i.e., wagering taxes and residual payments) will not begin to be received until approximately December 2002.

The Restricted Capital Fund must be expended by the end of FY 2007. Once this Fund is depleted, certain debt service payments (prison infrastructure bonds and a portion of the Regent's academic revenue bonds) will need to be paid from an alternative source, such as the General Fund.

For further information regarding Iowa's tobacco settlement, please refer to the LFB web site at <http://staffweb.legis.state.ia.us/lfb/> for the following **Issue Reviews**:

- Iowa's Tobacco Settlement dated October 8, 2001.
- Endowment for Iowa's Health Account – Analysis of Projected Value dated 2002.
- Restricted Capital Funds Account of the Tobacco Settlement Trust Fund dated October 8, 2002.

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Iowa's Tobacco Settlement  
Review of Securitization and Legislation  
<http://staffweb.legis.state.ia.us/lfb/IREVIEW/ireview.htm>  
LFB: IRBAL003.Doc/10/15/02/2:30 pm

## Tobacco Settlement Trust Fund Endowment for Iowa's Health Account

	<u>Estimated FY 2002</u>	<u>Legislative Action FY 2003</u>
<b>Resources</b>		
Balance	\$ 0	\$ 22,524,980
Bond Proceeds	39,551,202	0
General Fund Transfers	7,175,520 <sup>1</sup>	27,087,000
Deappropriation (HF 2615)	0	-27,087,000 <sup>6</sup>
Wagering Tax Allocation	80,000,000	75,000,000
22.0% of MSA Payment	13,998,027	13,845,572
Tobacco Settlement Residuals	0	12,070,223
Interest Earned	1,300,231	1,048,000
<b>Total</b>	<u>\$ 142,024,980</u>	<u>\$ 124,488,775</u>
<b>Appropriations</b>		
Healthy Iowans Tobacco Trust	\$ 55,000,000	\$ 55,825,000
Healthy Iowans Tobacco Trust (HF 2615)	0	9,000,000 <sup>2</sup>
Transfer to General Fund (HF 2627)		9,000,000 <sup>8</sup>
Student Achievement/Teacher Quality Act	40,000,000	0
School Aid Appropriation (SF 2315)	0	20,000,000 <sup>3</sup>
Tuition Replacement (HF 2614)	0	16,843,772 <sup>5</sup>
Transfer to Gen. Fund-Wagering Tax (SF 2304)	15,000,000	0
Transfer to Gen. Fund (SF 2304)	7,000,000	0
Medicaid Supplemental (HF 2245)	2,500,000 <sup>4</sup>	0
<b>Total</b>	<u>\$ 119,500,000</u>	<u>\$ 110,668,772</u>
<b>Ending Balance</b>	<u>\$ 22,524,980</u>	<u>\$ 13,820,003</u>

**NOTES:**

- <sup>1</sup> The original General Fund Transfer of \$7,248,000 was reduced by the 1.0% across-the-board reduction (\$72,480) made in SF 2304 (FY 2002 Budget Adjustment Act).
- <sup>2</sup> House File 2615 (FY 2003 Healthy Iowans Tobacco Trust Appropriations Act) transferred \$9,000,000 from the FY 2003 Wagering Tax allocation to the Healthy Iowans Tobacco Trust.
- <sup>3</sup> Senate File 2315 (FY 2003 School Aid Foundation Act) appropriated \$20,000,000 from the Endowment's FY 2003 Wagering Tax allocation for School Foundation Aid.
- <sup>4</sup> House File 2245 (FY 2002 Medicaid Supplemental Appropriations Act) appropriated \$2,500,000 from the Endowment for Department of Human Services (DHS) Medicaid.
- <sup>5</sup> House File 2614 (FY 2003 Infrastructure Appropriations Act) appropriated \$16,843,772 from the FY 2003 Wagering Tax allocation to the Endowment for Tuition Replacement.
- <sup>6</sup> House File 2615 (FY 2003 Healthy Iowans Tobacco Trust Appropriations Act) eliminated the FY 2003 General Fund appropriation of \$27,087,000.
- <sup>7</sup> House File 2075 (2002 Endowment Reimbursement Act) committed future General Fund receipts to reimburse the Endowment \$40,000,000 for the Student Achievement/Teacher Quality Act (2001 Session). House File 2075 also reimburses the Endowment an additional \$44,500,000 for the following: FY 2003 School Aid appropriation of \$20,000,000, FY 2002 Medicaid Supplemental appropriation of \$2,500,000, and the \$22,000,000 transferred to the General Fund in FY 2002.
- <sup>8</sup> House File 2627 (FY 2003 Second Omnibus Appropriations Act) transferred \$9,000,000 from the Endowment to the General Fund. House File 2625 (FY 2002 Adjustments and Transfers Act) increased the amount of money to be repaid to the Endowment from \$44,500,000 to \$53,500,000.

# Healthy Iowans Tobacco Trust Fund

## Balance Sheet

	Estimated FY 2002	Legislative Action FY 2003
<b>Resources</b>		
Balance Forward	\$ 11,305,232	530,697
Transfer from the Endowment for Iowa's Health Account	55,000,000	55,825,000
Endowment (Wagering Tax Allocation)	0	9,000,000
Interest Earned	537,616	
Interest Receivables	17,799	
Miscellaneous	119	0
<b>Total Available Resources</b>	<b>\$ 66,860,766</b>	<b>\$ 65,355,697</b>
<b>Appropriations</b>		
Dept. of Public Health		
Tobacco Use Prevention/Control	\$ 9,345,394	\$ 5,000,000
Substance Abuse	11,825,000	10,000,000
Healthy Iowans 2010	2,550,000	2,390,064
Smoking Cessation Products	75,000	75,000
Substance Abuse Treatment Facility	2,000,000	0
<b>Total Dept. of Public Health</b>	<b>\$ 25,795,394</b>	<b>\$ 17,465,064</b>
Dept. of Human Services		
Physician and other medical providers	\$ 8,095,718	\$ 8,095,718
Dental Provider	3,814,973	3,814,973
Hospital Provider	3,035,278	3,035,278
Home Health Care Provider	2,108,279	2,108,279
Critical Access Hospitals	250,000	250,000
Home Health and Habilitative Day Care Expansion	1,975,496	1,975,496
Respite Care Expansion	1,137,309	1,137,309
CHIP Expansion to 200% of Federal Poverty Level	200,000	200,000
Breast/Cervical Cancer Treatment	250,000	250,000
Medicaid Supplement	7,500,000	17,500,000
Res. Treatment Support Services Provider	3,243,026	3,243,026
Adoption, Ind. Living, Shelter Care, and Home Studies Pro.	468,967	468,967
Provider Rate/Methodology Changes	545,630	545,630
HIPAA Implementation	0	2,100,000
Purchase of Service Provider	146,750	146,750
<b>Total Dept. of Human Services</b>	<b>\$ 32,771,426</b>	<b>\$ 44,871,426</b>
Dept. of Corrections		
CBC District II	\$ 127,217	127,217
CBC District III	35,359	35,359
CBC District IV	191,731	191,731
CBC District V	255,692	255,693
Fort Madison Special Needs Unit	0	1,100,000
<b>Total Dept. of Corrections</b>	<b>\$ 609,999</b>	<b>\$ 1,710,000</b>
Dept. of Education		
Iowa Empowerment Fund	\$ 1,153,250	\$ 1,153,250
Transfer to General Fund (SF 2403)	6,000,000	0
<b>Total Appropriations</b>	<b>\$ 66,330,069</b>	<b>\$ 65,199,740</b>
<b>Ending Balance</b>	<b>\$ 530,697</b>	<b>\$ 155,957</b>

Approximately \$1.9 million of the \$2.0 million FY 2002 appropriation to the Department of Public Health (DPH) for the substance abuse treatment facility remained unexpended at the end of FY 2002. House File 2615 permits the FY 2002 ending balance to carry forward to FY 2003 to be used as follows: \$27,409 for the Poison Control Center in the DPH, \$172,591 for a value-based program at the Newton Correctional Facility, and the remainder for substance abuse treatment programs.

## Tobacco Settlement Trust Fund Restricted Capital Fund

	Estimated FY 2002	Legislative Action FY 2003
<b>Resources</b>		
Balance Forward	\$ 0	\$ 427,502,639
Tax-Exempt Bond Proceeds	540,045,010	0
Interest	13,208,002	17,100,106
Miscellaneous	307	0
<b>Total Available Resources</b>	<b>\$ 553,253,319</b>	<b>\$ 444,602,745</b>
<b>Appropriations</b>		
Dept. of Corrections		
Fort Madison Prison Expansion	\$ 6,400,000	\$ 2,000,000
Security Fencing	0	3,523,850
Oakdale Bed Expansion	0	4,100,000
Oakdale Water Access	100,000	0
Mitchellville Waste Water Facility	364,400	0
Total Corrections	<b>\$ 6,864,400</b>	<b>\$ 9,623,850</b>
Dept. of Economic Development		
Accelerated Career Education (ACE) Program	\$ 2,500,000	\$ 2,500,000
Advanced Research and Commercialization	0	3,268,696
Total Economic Development	<b>\$ 2,500,000</b>	<b>\$ 5,768,696</b>
Dept. of Education		
IPTV - High Definition TV Conversion	\$ 2,400,000	\$ 1,000,000
Dept. of General Services		
Major Maintenance	\$ 11,500,000	\$ 15,750,000
Capitol Interior Renovation	1,700,000	2,700,000
Capitol Interior Renovation N.E. Quadrant	0	5,000,000
Des Moines Metro. Medical Center Option	500,000	0
Parking Structure	0	3,400,000
Property Appraisal	250,000	0
Court Avenue Bridge	0	0
Parking Lot 8 Design & Removal	0	93,000
Micrographics Building Demolition	0	170,000
Capitol Complex Security Upgrades	0	1,000,000
Records & Property Bldg. Renovation	0	1,600,000
Property Acquisition & Site Development	200,000	0
Laboratory Facility	16,670,000	16,670,000
Total General Services	<b>\$ 30,820,000</b>	<b>\$ 46,383,000</b>
Dept. of Human Services		
Alternative Services Facility Construction	\$ 0	\$ 200,000
Judicial Branch		
Pave 12th Street South of Court Ave	\$ 0	\$ 700,000
Building Furnishings	0	1,250,000
Facility Design/Construction	10,300,000	0
Total Judicial Branch	<b>\$ 10,300,000</b>	<b>\$ 1,950,000</b>
Information Technology Department		
Enterprise Resource Planning System	\$ 0	\$ 4,400,000

## Tobacco Settlement Trust Fund Restricted Capital Fund

	Estimated FY 2002	Legislative Action FY 2003
Dept. of Natural Resources		
Restore the Outdoors Program	\$ 2,500,000	\$ 2,500,000
Destination State Park	1,000,000	1,000,000
Lewis & Clark Rural Water System	0	281,400
<b>Total Natural Resources</b>	<b>\$ 3,500,000</b>	<b>\$ 3,781,400</b>
Dept. of Public Defense		
Armory Maintenance	\$ 700,000	\$ 700,000
Boone Armory	0	111,000
Waterloo Armory	0	612,100
Estherville Readiness Center	400,000	400,000
<b>Total Public Defense</b>	<b>\$ 1,100,000</b>	<b>\$ 1,823,100</b>
Board of Regents		
Regents - Tuition Replacement	\$ 600,860	\$ 10,503,733
Regents - Lakeside Lab Facility	0	390,000
ISU - Gilman Hall	2,500,000	0
ISU - Classrooms & Auditoriums	0	2,112,100
ISU - Business Building	4,200,000	6,700,000
ISU - Livestock Research Facility	0	2,797,000
ISU - Plant Sciences	0	4,148,000
SUI - School of Journalism Building	0	2,600,000
SUI - Biology Building Renovation	7,300,000	3,000,000
SUI - Art Building	4,453,000	7,910,000
UNI - Teaching Center Bldg. (East Gym)	0	1,730,000
UNI - McCollum Hall	5,800,000	8,400,000
UNI - Steam Distribution	3,990,000	4,320,000
Special Schools	835,000	885,000
<b>Total Regents</b>	<b>\$ 29,678,860</b>	<b>\$ 55,495,833</b>
State Fair Authority		
State Fair Maintenance	\$ 500,000	\$ 500,000
Telecommunications & Technology Commission		
ICN - ATM Conversion	\$ 3,500,000	\$ 5,000,000
Dept. of Transportation		
Recreational Trails	\$ 1,000,000	\$ 2,000,000
Commercial Aviation Infrastructure	1,000,000	1,100,000
General Aviation Airports	500,000	581,400
<b>Total Transportation</b>	<b>\$ 2,500,000</b>	<b>\$ 3,681,400</b>
Treasurer of State		
County Fairs	\$ 1,060,000	\$ 1,060,000
Prison Construction Debt Service	5,182,089	5,417,250
ICN - Debt Service	1,465,443	13,044,784
Attorney Litigation Payments	10,617,000	14,924,000
Attorney Litigation Payments Supp. SF 2317	944,880	0
Community Attraction/Tourism	12,500,000	12,500,000
<b>Total Treasurer of State</b>	<b>\$ 31,769,412</b>	<b>\$ 46,946,034</b>
Tobacco Asettlement Authority (TSA)		
Enforcement Contingency	\$ 200,000	\$ 0
TSA operations	118,008	200,000
<b>Total Tobacco Settlement Authority</b>	<b>318,008</b>	<b>200,000</b>
<b>Total Appropriations</b>	<b>\$ 125,750,680</b>	<b>\$ 186,753,313</b>
<b>Ending Balance</b>	<b>\$ 427,502,639</b>	<b>\$ 257,849,432</b>